

Applying Sales Tax to Tips and Related Payments

Business people who provide services often receive tips from their customers. This fact sheet provides basic information regarding how sales tax applies to tips and related amounts paid to a business and its employees.

Sales tax does not apply if a tip is given for a service that is not associated with a taxable sale. Examples include tips given for carrying luggage, parking a car, cleaning a hotel room, or driving a cab.

However, customers frequently give tips for a service that contributes to a taxable sale, such as the sale and service of meals or drinks in a restaurant. Those tips may be taxable, as explained below.

When are tips taxable? Voluntary tips vs. mandatory tips

For sales tax purposes, we separate tips associated with taxable sales and service into two basic categories: *voluntary* tips, which are generally *not* taxable, and *mandatory* tips, which are.

Voluntary tips

Nontaxable voluntary tips include

- Amounts paid by customers directly to an employee, when the customer has made no advance arrangement with the business regarding the amount of the tip *and* the employee retains the tip. This is the typical arrangement in most restaurants — the customer decides how much to tip the server and leaves that amount at the end of the meal.
- Amounts paid to a caterer, if any, *in addition to* the tip amount specified in a catering contract, provided the customer voluntarily offers the tip and the caterer passes it on to his or her employees.

Mandatory tips

Your business owes sales tax on all mandatory tip amounts paid by your customers. Mandatory tips include

- Amounts you add to meal or beverage prices, when you notify your customers that you will add an amount for tips to the price of their meals or drinks. Typically that kind of notice would be printed on your menus or in your brochures or advertisements.
- Amounts for tips you list on a meal or beverage receipt before giving the receipt to the customer.
- Any tip or gratuity amount or percentage agreed to by your customer before a meal, banquet, or catered event, whether the customer agrees orally or by signing a written contract (see next section).

More ►

Sales and Use TAX FACTS

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For additional information
you may wish to order
the reference material listed
on the reverse
or talk to a Board of
Equalization representative.
For assistance, please call
1-800-400-7115
(for the hearing-impaired:
— from TDD phone:
800-735-2929;
— from voice phone:
800-735-2922).
Internet: www.boe.ca.gov

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Pooled tips for taxable and nontaxable services

Tax does not apply to any portion of a mandatory tip paid to employees who provide only services that are *not* directly related to your taxable sale. Examples include parking, entertainment, and security services provided in conjunction with the taxable sale of hot, prepared food.

Take, for example, a fund-raising dinner catered by your company. In addition to preparing and serving the meal, you also provide valet parking. Your contract requires the customer to pay a lump-sum tip in addition to your other charges. Tax applies to all charges directly related to the preparation and service of the meal. But if you divide the tip among employees who prepare and serve food and those who provide parking, the portion paid to the parking employees is not taxable.

Please note: If you divide pooled or lump-sum tips among employees who provide services directly related to your taxable sales and those who provide nontaxable services, your invoice and your business records must clearly document the specific percentage or amount paid to each type of employee and the service provided. The percentage or other method for dividing tips should be determined before the sale takes place.

Other charges related to the sale of meals or beverages

Service charges

Service charges related to the taxable sale of meals or beverages are also taxable, even if you pass on the amounts to your employees. This is true whether you intend the service charges to replace tips or add to them.

Cover charges

A cover charge is taxable if it allows your customer to consume food or beverages served on the premises without paying additional amounts for them. This is true even if the customer does not consume any food or beverages, or if the value of the food or beverages is less than the cover charge. Separate cover charges for admission only are not taxable.

Corkage charges

Charges for opening and serving a customer-furnished beverage are generally taxable.

Reporting taxable tips and related charges

When you complete your sales and use tax return, the amount you list for total sales must include all taxable tips and other taxable charges explained in this fact sheet. You must include mandatory tips and taxable charges even if you pass those amounts on to your employees. You cannot take a deduction on your sales and use tax return for tips paid to employees.

For more information

If you need more detailed information, you may wish to order the documents below from our Information Center or Internet site. You can also call our Information Center for help.

Regulations

1603 Taxable Sales of Food Products

Publications

22 Tax Tips for the Dining and Beverage Industry

Note: The statements in this fact sheet are general and are current as of August 2000. The sales and use tax law and regulations are complex and subject to change. If there is a conflict between this publication and the law or regulations, decisions will be based on the law and regulations.